R. J. REYNOLDS INDUSTRIES, INC. · 1970 ANNUAL REPORT

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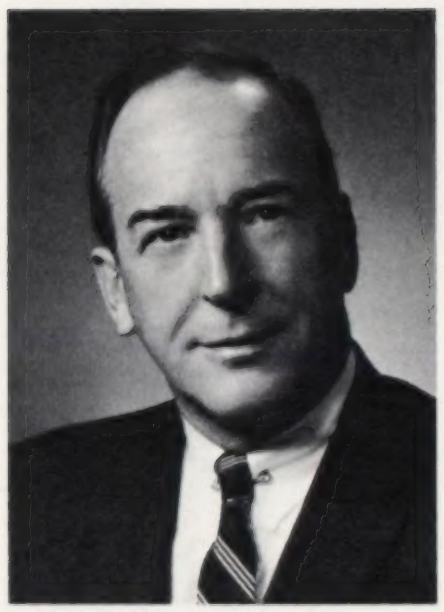
Comparative Summary

Consolidated
(Dollar Amounts in Thousands Except Share Statistics)

	1970	1969
Net sales and operating revenues	$2,484,599	$2,252,695
Net earnings	201,885	172,305
Per common share	4.56	3.82
Per common share—assuming full dilution	4.10	3.57
Net earnings as a percentage of net sales and operating revenues	8.13%	7.65%
Dividends paid on Preferred stocks	$ 18,275	$ 11,538
Dividends paid on Common Stock	96,584	90,530
Per share of Common Stock	2.40	2.25
Average number of common shares outstanding	40,242,252	40,235,578
Average number of common shares outstanding—assuming full dilution	49,188,427	48,123,711
Capital expenditures	$ 164,619	$ 197,903
Depreciation and amortization	57,153	45,369
Total assets	$1,857,651	$1,693,373
Current assets	902,436	921,488
Current liabilities	330,647	298,607
Net current assets—working capital	571,789	622,881
Property, plant and equipment—net	627,927	524,876
Long-term debt (less current maturities)	296,094	274,031
Book value of Preferred Stock	85,783	85,774
Book value of Common Stock	1,082,155	992,950
Number of RJR stockholders at year-end	137,504	136,539
Number of regular employees at year-end	28,255	27,969

To the Stockholders



A. H. Galloway

David S. Peoples

This is the first annual report to you from the new corporation, R. J. Reynolds Industries, Inc. Since our last report we have reorganized the corporate structure as approved by the stockholders at their annual meeting last April. This has permitted clearer definition of duties of key personnel and corresponding clarity in individual accountabilities. We are well pleased with the results.

Net sales and operating revenues and consolidated net earnings for 1970 achieved new highs.

Increases in net sales or operating revenues were posted by all segments of the Company's operations. Particularly gratifying was the 2.4 percent increase in cigarette unit sales. Improved transportation revenues were attributable to expanded trade routes and to lower than normal revenues in 1969 as a result of the longshoremen's strike in that year. Sales of other products (including food, aluminum products and packaging, and industrial corn products) increased $31,344,000.

Tobacco earnings from operations were up substantially, but transportation earnings from operations declined, reflecting increased competition, higher operating costs, and the cost of expanding trade routes. Earnings from operations of the Company's other businesses were impressive, doubling the prior year. This was accounted for by the food, aluminum products and packaging, and industrial corn refining segments and the inclusion of American Independent Oil Company (Aminoil) in the fourth fiscal period.

The acquisition of Aminoil on September 1, 1970, which was discussed in our third-quarter interim report, was a culmination of an extended study the Company had made of natural resource energy and the critical underestimation of the world's long-range energy requirements. In future operations in this area we intend to act with caution and careful selection in trying to locate new sources. Since the close of the year, Aminoil has announced that it has entered into an oil exploration and development agreement with White Shield Indonesia Oil Corp. covering an area in offshore Indonesia along the west coast of Java and the south coast of Sumatra encompassing approximately 17 million acres. Aminoil, as operator, plans to initiate its drilling program during the first half of 1971.

We would like to review for you the status of our efforts to acquire United States Lines, Inc., from Walter Kidde and Company, Inc. As you know, during 1969 we entered into an agreement under which U. S. Lines would charter its containership fleet to Sea-Land Service, Inc.

In October, 1970, and prior to final decision by the Federal Maritime Commission on the charter agreement, an opportunity arose under which we could acquire U. S. Lines at significantly less cost over a period of time than would be incurred on the proposed charter basis. Accordingly, new agreements were announced on November 9 under which, subject to approval by the Federal Maritime Commission and the Interstate Commerce Commission and such approvals of the Federal Maritime Administration as may be required, Reynolds Industries through a subsidiary would acquire all of the capital stock of United States Lines in exchange for a promissory note of R. J. Reynolds Tobacco Company for $65,000,000. If the necessary approvals are not obtained, Reynolds Tobacco will be required to produce for Kidde consideration equivalent to the purchase price and U. S. Lines will be sold or disposed of otherwise for the account of Reynolds Tobacco.

On December 15, 1970, the U. S. Department of Justice filed a suit in the United States District Court for the District of New Jersey contending that the new agreements violate the antitrust laws, and seeking an injunction prohibiting the proposed transaction. The Federal Maritime Commission has moved to block the Justice Department's lawsuit. Hearings before the Commission began February 17, 1971, and it is not known how much time will elapse be-

fore a determination is ultimately made by the Commission. As of the date of this letter, the court had not made a decision on the Commission's motion to block the Justice Department's lawsuit. (Additional details are presented in Notes H and I of Notes To Consolidated Financial Statements.)

Before signing the new agreements of November 9, we had carefully considered any possible antitrust problems involved. At the time the proposed acquisition was announced, applications were filed with the Federal Maritime Commission and with the Interstate Commerce Commission seeking the approval of those agencies as required by law before the acquisition can be effected. The statutes enacted by the Congress governing the commerce of the United States vest in those agencies the authority to approve transactions of the kind contemplated where they appear to be in the public interest taking into account all facets of the public interest, including the antitrust laws.

Naturally, it is our hope and intention to earn profits for the Company through this acquisition, if allowed. At the same time, we earnestly believe that this merger will enable American shipping to compete more effectively with foreign shipping interests.

Worth noting in this regard is the fact that the initial decision of the Federal Maritime Commission Hearing Examiner, after hearings on the original charter agreement, determined that "the industry needs — because shippers deserve — the service which can at this time be made available only by Sea-Land with the use of the U. S. Lines containership fleet through our approval of the agreement, and which will be an important public benefit; and we find that the conduct thus legalized does not invade the prohibitions of the antitrust laws any more than is necessary to serve the purposes of the Shipping Act."

We turn now to the pending divestiture of our corn refining subsidiary, Penick & Ford, Limited. As you can understand, the credit squeeze and the fall-off in the market for stocks which the country has been experiencing have complicated our search for a suitable purchaser. We are continuing our extensive efforts to comply with the required divestiture by September, 1971.

We are pursuing our negotiations with Rothmans International Group, announced on January 21, 1971, looking toward joint efforts through subsidiaries in the production and marketing of cigarettes and other tobacco products in various areas of the world other than North America and Africa. The form and nature of the future association will be determined in these negotiations, and there is nothing further that we can add to the original announcement at this time.

We would not want to close this letter without expressing our appreciation for the loyalty and efficiency of the employees of the Company and its subsidiaries throughout the past year. Their cooperation during the transitional phases of reorganization has been — as we had expected it would be — outstanding. We are also grateful for the continuing support of the more than 137,000 stockholders and their interest in the progress of the Company.

Respectfully submitted for the Board of Directors.

Chairman, Board of Directors

President

February 19, 1971

P.S. Right now, while you are thinking about it, you can do something to help your Company with one of its biggest problems. We urgently ask you to write to the representatives in your state legislature and let them know that you are opposed to unreasonable and punitive state cigarette taxes which directly influence your investment in our Company. Many thanks.

Tobacco

Domestic and International Sales Increases Reported

R. J. Reynolds Tobacco Company, experiencing sales gains in both its domestic and its international business, had a good year in 1970.

The company continued to lead all others in domestic cigarette sales, and outperformed the industry, which appears to have had a slight sales gain over 1969. Many Reynolds brands contributed to the sales growth, including WINSTON, SALEM, CAMEL Filter, DORAL and VANTAGE.

WINSTON, the best-selling cigarette in the United States, expanded its lead over the No. 2 brand, while SALEM continued to be the No. 1 menthol brand. CAMEL Regular performed better than its category overall, although both the brand and the category continued to decline. A strong performance by CAMEL Filter partially offset the loss CAMEL Regular experienced in 1970.

DORAL, introduced in 1969, is one of the most successful new brands in recent years, and contributed significantly to the company's strong performance in 1970. VANTAGE, Reynolds' newest brand, was introduced in initial markets last July, and went into national distribution November 2. VANTAGE has already achieved a sufficient share of market to be deemed a successful brand. The rapid initial success of VANTAGE supports the company's belief that this new brand offers smokers full tobacco flavor comparable to the best-selling brands on the market while delivering low "tar" and nicotine levels.

WINSTON Super King kept its lead in the 100-millimeter field, and SALEM Super King continued to lead the menthol 100-millimeter category, both by substantial margins.

For the first time in several years, the company and the industry overall experienced a gain in total smoking tobacco sales. While PRINCE ALBERT maintained its position as the nation's largest-selling smoking tobacco, Reynolds' gain in smoking tobacco sales was due primarily to a continued increase in volume by CARTER HALL and a significant sales improvement by MADEIRA MIXTURE, the company's aromatic blend.

In the chewing tobacco market, DAYS WORK remained the leading plug brand, and performed better than the plug market overall.

The improved performance of Reynolds' cigarette brands in 1970 came despite the fact that many states continued to increase their discriminatory taxes and the fact that the unreasonable campaigns of anti-smoking forces were as unrelenting as ever.

Taxation continues to be a major deterrent to greater growth for cigarette sales. According to the Tobacco Tax Council, the median price per package of cigarettes at retail in the United States is now 38.9 cents, including an average tax (Federal and state) of 19 cents. A year earlier the median per package price was 37.1 cents. A decade ago, the most prevalent state cigarette tax was 3 cents per package; today more than half the states are imposing rates of 10 cents or more. At the end of 1970, according to the Tax Council, cigarette taxes imposed at the three levels of government made the cost of cigarettes to consumers approximately twice as high as it would have been in the absence of taxes.

Commenting on the anti-smoking campaigns, Horace Kornegay, president of The Tobacco Institute, said recently that it is apparent that those national organizations opposed to smoking "misjudged public gullibility when they diverted their funds from

R. J. Reynolds Tobacco Company
Winston-Salem, North Carolina
Colin Stokes, Chairman and Chief Operating Officer
William S. Smith, President and Chief Executive Officer

Salem
Winston
KING SIZE
Winston
Winston
R. J. REYNOLDS TOBACCO CO.
WINSTON-SALEM N.C. 27102 U.S.A.
VANTAGE
MEL
Menthol Fresh
VANTAGE
MEL
Salem
FILTER CIGAR
DOMESTIC

research into efforts to control individual behavior without supportive facts."

The tobacco industry has funded more scientific research on smoking and health problems than has any other source, governmental or private. In 1971 Reynolds and other members of the tobacco industry will pool more than $4 million for support of such research through the Council for Tobacco Research—USA and the Education and Research Foundation of the American Medical Association.

Congress in 1970 passed legislation altering the caution label required on all cigarette packages and banning all cigarette advertising from radio and television. Denied the right to advertise on the electronic media, the company is using new ways to merchandise its cigarette products and keep the brand names before the adult smoking public. One way is through sponsorship of special events, such as bowling and stock car racing. Reynolds feels its participation in these events will create an identification for the company's brands with people at the events and with the fans who follow them. More reliance than ever is being placed on the sales force to promote Reynolds brands in outlets around the country. An increase in print media and outdoor advertising, plus more promotional activities such as last year's highly successful "Win With Winston" sweepstakes, will provide additional support and help Reynolds maintain its position as the industry's leading tobacco company.

Reynolds Tobacco has a natural concern for all aspects of the tobacco economy. To help assure an adequate supply of its basic raw material, the company continued its long-time financial support of selected projects at agricultural experiment stations in the major tobacco-growing states. Pursuing a project begun in 1969 to help tobacco farmers overcome a labor shortage, Reynolds completed a production model of a compact mechanical harvester. An agreement for the commercial production of the harvester was signed in late 1970, and the manufacturer plans to have a limited number of the harvesters available for sale before the 1971 flue-cured crop is ready.

Despite the problems that beset the industry, Reynolds believes strongly that tobacco will continue to be a good and profitable business.

International Tobacco Operations

Recognizing the growth potential for cigarettes in foreign markets, Reynolds continued to capitalize on expansion opportunities in 1970, and the company's brands experienced sales growth in the licensee, subsidiary and commercial export areas.

The company increased its total cigarette exports during 1970 and maintained its leadership as the largest exporter of cigarettes from the United States. The gain in commercial exports came despite a decline in military export sales resulting from substantial reduction in United States troop strengths overseas. WINSTON continues to be the company's strongest export brand.

Sales continued to improve for R. J. Reynolds (Europe) S. A., the company's subsidiary which has responsibility for both export and direct international operations in Europe, Africa and the Middle East. CAMEL Filter continued to do well in West Germany, and its success spread to Holland and Switzerland.

To meet the increased demand, two of the company's European manufacturing subsidiaries have new cigarette factories under construction, one in Trier, West Germany, and another in Dagmersellen near Lucerne, Switzerland. The plant in Switzerland will be completed in mid-1971, while the factory in West Germany is scheduled to be in operation at the end of the year.

Reynolds' International Division, which has responsibility for all foreign operations outside Europe, Africa and the Middle East, also reported major strides.

The wholly owned subsidiary in Puerto Rico completed construction of its plant there, and by September the factory was producing Reynolds brands. This plant will supply cigarettes for the company's business throughout Puerto Rico, where Reynolds brands are already the largest-selling. The plant will eventually supply cigarettes for other markets in the Caribbean.

Sylvana Tobacco Corporation, Reynolds' licensee in the Philippines, began production of CAMEL cigarettes in October, 1970.

In mid-1970, the International Division formed a subsidiary in Hong Kong to conduct import and export operations for the

company's tobacco products in several Far Eastern markets. The subsidiary operates as a trading company, with all cigarettes manufactured in Winston-Salem and shipped directly to sub-distributors in Hong Kong and more than a dozen additional Asian markets, where total cigarette consumption is on the increase.

A licensing agreement was concluded in 1970 with Macdonald Tobacco, Inc. for the manufacture and sale of special Canadian blend WINSTON and SALEM brands in Canada. The cigarettes, manufactured in Montreal by Macdonald, have been in selected test market areas since October. Macdonald has also taken over distribution in Canada of Reynolds' other brands, including United States-made WINSTON and SALEM.

R. J. REYNOLDS TOBACCO COMPANY —
INTERNATIONAL DIVISION
Winston-Salem, North Carolina
H. E. RICHMILLER, President

R. J. REYNOLDS COMPANY
San Juan, Puerto Rico
JACK AFRICK, President

FABRICA de CIGARROS BALOYAN, S.A.
Tijuana, Mexico
B. T. TROY, President

R. J. REYNOLDS TOBACCO CO. (HONG KONG), LTD.
Hong Kong
M. L. WHITE, General Manager

TABACALERA NACIONAL, S.A. (Licensee)
Lima, Peru

SYLVANA TOBACCO CORPORATION (Licensee)
Manila, Philippines

MACDONALD TOBACCO, INC. (Licensee)
Montreal, Quebec, Canada

R. J. REYNOLDS (EUROPE) S.A.
Geneva, Switzerland
JACQUES E. BORIN, President

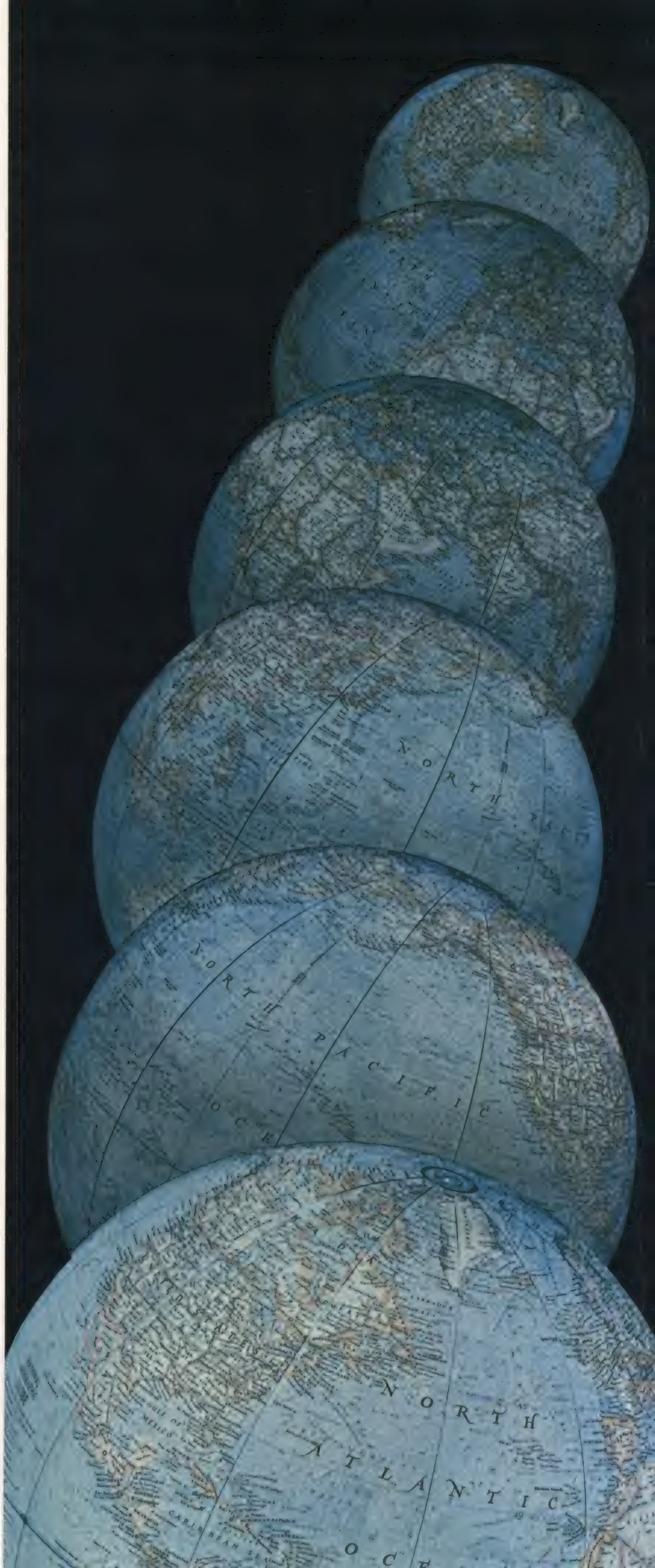
REYNOLDS-NEUERBURG G.m.b.H.
Cologne, West Germany
DR. HANS BÜHLER, General Manager

REYNOLDS CIGARETTE CORPORATION
Aarau, Switzerland
MAURICE PERRET, Manager

THEODORUS NIEMEYER, N.V. (Licensee)
Groningen, Holland

AUSTRIA TABAKWERKE, A.G. (Licensee)
Vienna, Austria

GLENN TOBACCO COMPANY
Athens, Greece
EDWIN M. LEIGHT, Manager



Containerized Freight Transportation

Global Service Expanded In Important Trade Areas

Sea-Land Service, Inc., the major operating company of McLean Industries, Inc., continued in 1970 to broaden its containerized freight service in important trade areas of the world, further developing a complete and unified transportation system which permits the interchange of cargo between virtually any two points in Sea-Land's global network.

In February, 1970, the Sea-Land containership *Bienville* brought containerized shipping capability to southern Spain and France and to Italy, and introduced into that trade area the high-capacity, 35-foot container.

Service also was expanded among the islands of the Caribbean. Jamaica became part of Sea-Land's network early in 1970. Already being served by Sea-Land were Puerto Rico —which had known Sea-Land Service almost from its inception—the Virgin Islands and the Dominican Republic. In August, Haiti, Trinidad and Curacao were added to the list of Caribbean islands being called on weekly by Sea-Land containerships.

In May, a new interport service connecting Hong Kong, Taiwan, Korea and Japan was inaugurated, making Sea-Land containerized freight service available between these Far East countries on a regular basis, and connecting them with United States West and East Coast ports, as well as with the Caribbean.

Sea-Land also broadened service in the United States, adding Boston and Port Everglades, Florida, to its East Coast ports of call in mid-July. Port Everglades serves southern Florida.

The year also saw numerous changes and enlargements at various established ports of call, such as the complete movement of Sea-Land's Rotterdam facilities into larger, more efficient quarters.

On July 10, the Sea-Land containership *Panama* was the first vessel to arrive at the new $309 million, Kobe, Japan, Port Island complex.

Sea-Land's growth in service during 1970 resulted in larger volume, but because of start-up costs associated with this expansion and other factors affecting the industry, profits were lower than in 1969.

McLean Industries, Inc.
Elizabeth, New Jersey
Malcom P. McLean, President

Sea-Land Service, Inc.
Elizabeth, New Jersey
Michael R. McEvoy, Chairman

SEA LAND
PORTLAND

Foods and Beverages

Sales and Profits Up; New Products Introduced

Continued substantial growth in sales and profits and the successful introduction of new products were the highlights of 1970 for RJR Foods, Inc.

The company maintained its leadership in Oriental-style and Mexican-style foods through the development and introduction of CHUN KING five-course frozen Oriental dinners and PATIO five-course frozen Mexican dinners. Also popular within a short period after introduction were the CHUN KING "Recipe-in-a-Box" dinners, which call for creativity on the part of the housewife, while providing convenience.

Other successful new products include the MY*T*FINE Rich 'n Ready canned pudding line, HAWAIIAN PUNCH flavors of Apple-Red, Lemon-Pink and Sunshine Orange, and VERMONT MAID in a plastic bottle.

One factor credited with helping RJR Foods products make substantial strides during 1970 was the heavy support provided through advertising, much of it totally new. The company's advertising during the year demonstrated that strong research into consumer motivation, translated into creative copy and graphics, can have a vivid impact.

A new series of commercials for CHUN KING has been filmed in Hong Kong and Taiwan, placing the Oriental foods in an authentic background. Pretesting of these commercials indicates strong consumer acceptance. In addition, advertising support during prime time on television in 1971 will be the strongest ever to help this brand.

Two types of television advertising have been developed to support PATIO for 1971, one designed for the East where Mexican foods are relatively new and another for the Southwest and West where they are popular.

Among other brands, HAWAIIAN PUNCH has intensified its television advertising, particularly for frozen concentrate. BRER RABBIT molasses has increased its print media advertising, stressing its wide variety of uses as an ingredient, and COLLEGE INN is devoting its primary effort to a national cooking contest among high school students and home economics teachers.

RJR Foods achieved widespread recognition in 1970 through its first sponsorship of a television special, "Tales From Muppetland." This special featured Muppet puppets known across the country because of their appearances on the "Sesame Street" and "Ed Sullivan" television shows. Additional "Tales From Muppetland" television specials are planned for 1971, especially in support of HAWAIIAN PUNCH drinks.

New product development continues to receive great emphasis and a number of new products are scheduled for test marketing in 1971.

RJR Foods, Inc.
New York, New York
John Phillips, President

FRIED RICE
PAT'O
WAI
PUNC

Aluminum Products and Packaging

Increased Sales Reported By All Four Divisions

The addition of an entirely new division, increased sales, and expanded research and development facilities were the major developments during 1970 for RJR Archer, Inc.

Joining RJR Archer's Metals, Packaging and Consumer Products divisions during the year was RJR Filmco, which had been a separate subsidiary of R. J. Reynolds Tobacco Company until March, 1970.

All four operating divisions reported increases in sales over 1969, and for the third consecutive year RJR Archer sales to outside customers exceeded sales to the parent company and continued to represent an increasing percentage of the company's total sales.

RJR Filmco is intensifying its efforts to develop industrial films to help broaden its product lines. If this program is as successful as anticipated, RJR Filmco's capacity will be increased to meet market demands.

A second gift wrap line was put into full production during 1970 in the Consumer Products Division. The division also upgraded its entire line of gift wrap and introduced a new quality gift wrap which enabled it to increase its share of the quality gift wrap market.

The Packaging Division improved its market position during the year by the addition of new equipment which increased its extrusion capacity and capability. This new equipment enabled the division to increase significantly its sales of gravure-printed, multi-layered packaging materials which provide both beauty and protection for such convenience packaging users as the food and drug industries.

In the Metals Division, work was completed on an expansion project at a Winston-Salem plant, where a new continuous caster, melting complex was installed. The installation increases the plant's casting capacity more than 50 percent and gives this division the capability of producing the widest continuous cast aluminum in the industry. This additional capacity brings into better balance the division's casting, melting and rolling facilities and helps meet its requirements for continuous cast aluminum.

Last year was the first full year of three-shift operations for the division's Huntingdon, Tennessee, plant since its start-up in late 1967. The plant is now producing aluminum sheet and foil at a high level of capacity and efficiency.

In June, 1970, RJR Archer's Research and Development Department expanded its capability by the addition of a package development group. This new group had been a part of the corporate Product Development Department, but it was reassigned directly to RJR Archer under the corporate reorganization which took place last summer.

The improvements in all divisions helped RJR Archer have a good year in 1970 and add to the company's ability to meet the challenges of 1971.

RJR Archer, Inc.
Winston-Salem, North Carolina
W. Bradley Blair, President

FOIL

Market Bright for Main Product

American Independent Oil Company (Aminoil), acquired by Reynolds Industries on September 1, 1970, benefited during the year from the change from an oversupply of petroleum products to a relative scarcity of supply—especially in heavy fuel oil, which is Aminoil's main product.

Sales efforts were vigorously pursued throughout the year and volume increases over the level attained during the three previous years were recorded from Kuwait operations. Sales from Iran continued the steady increase that has been experienced there over the past several years. Aminoil has been successful in regaining a position in the European market and has concluded a substantial two-year contract that could lead to a permanent re-establishment of its marketing position west of Suez.

Because of the very high sulfur content of the Kuwait oil, Aminoil was one of the first companies in the industry to build a desulfurizing plant. This plant, which will eventually desulfurize almost half of Aminoil's Kuwait crude oil production, has encountered operating difficulties since start-up in 1969 and although it has not yet reached design capacity, steady improvement continues to be made. Desulfurization of the oil will result in a much cleaner-burning fuel.

The year 1970 was a time of changing relationships between the industry and the governments of the areas in which Aminoil operates. In Kuwait, British Petroleum and Gulf Oil increased the posted price of their crude oil and submitted to an increase in the income tax rate. The posted price negotiated by oil companies and the local governments is the price agreed upon for computing tax and royalty payments regardless of the actual selling price. At the end of the year, Aminoil was preparing to discuss revisions to its concession agreement with Kuwait.

In Iran, Aminoil increased the posted price of its heavy Iranian crude oil and submitted to an increase in the tax rate.

Exploration efforts continued in Abu Dhabi in the Persian Gulf and in Ecuador during 1970. There were no developments in Abu Dhabi that would give reason to believe that oil in commercial quantities will be found there by Aminoil. In Ecuador, the prospects are encouraging and Aminoil has continued, with its partners, in an aggressive exploration program. Three of the four exploratory wells which were drilled were discovery wells; however, evaluations have not yet permitted a determination as to whether the accumulations are commercial.

During 1970 Aminoil continued to look for concession opportunities throughout the world. At year-end, negotiations were essentially completed on the acquisition of a participating interest in a production-sharing contract in Indonesia.

American Independent Oil Company, New York, New York
J. B. Sunderland, President

Corn Refining

Remodeling Program Improving Operations

Operations of Penick & Ford, Limited showed a marked improvement in 1970 as the company's ongoing program of plant remodeling began to yield benefits of increased efficiency.

The company's remodeling program, which has been going on for the past few years and will continue in 1971, also includes the installation of new equipment, which has increased Penick & Ford's production capabilities. Equipment installed during 1970 enabled the company to use a new method of treating corn syrup. Additional machinery to expand the capacity of the improved refining process will be installed during 1971.

Several new products developed during the past year hold promise for continued gains in 1971.

Reynolds Industries must divest itself of Penick & Ford in accordance with the consent decree entered in 1969 in the antitrust case brought by the Department of Justice, attacking the acquisition of Penick & Ford. The decree requires divestiture by September, 1971, or before.

The former grocery division of Penick & Ford was transferred to RJR Foods, Inc. in 1967 and will not be part of the divestiture.

Penick & Ford, Limited, Cedar Rapids, Iowa
Paul E. Geiser, President

FINANCIAL REVIEW

Summary

Net sales and operating revenues of the Company were a record $2,484,599,000 in 1970 and consolidated net earnings reached a record $201,885,000 for the year.

Consolidated revenues rose 10% over 1969's record $2,252,695,000, an increase of $231,904,000. Consolidated net earnings advanced $29,580,000 or 17% over the 1969 amount of $172,305,000. Net earnings per share of Common Stock increased in 1970 to $4.56, up 74 cents over the $3.82 per share reported for 1969.

Diversification

The Company acquired the Common Stock of American Independent Oil Company (Aminoil) for $55,500,000 cash on September 1, 1970. Since this is a foreign operation, Aminoil's accounts are not consolidated, but its earnings from operations, interest expense and provision for income taxes for its fourth fiscal period in 1970 have been included in consolidated results on the equity basis.

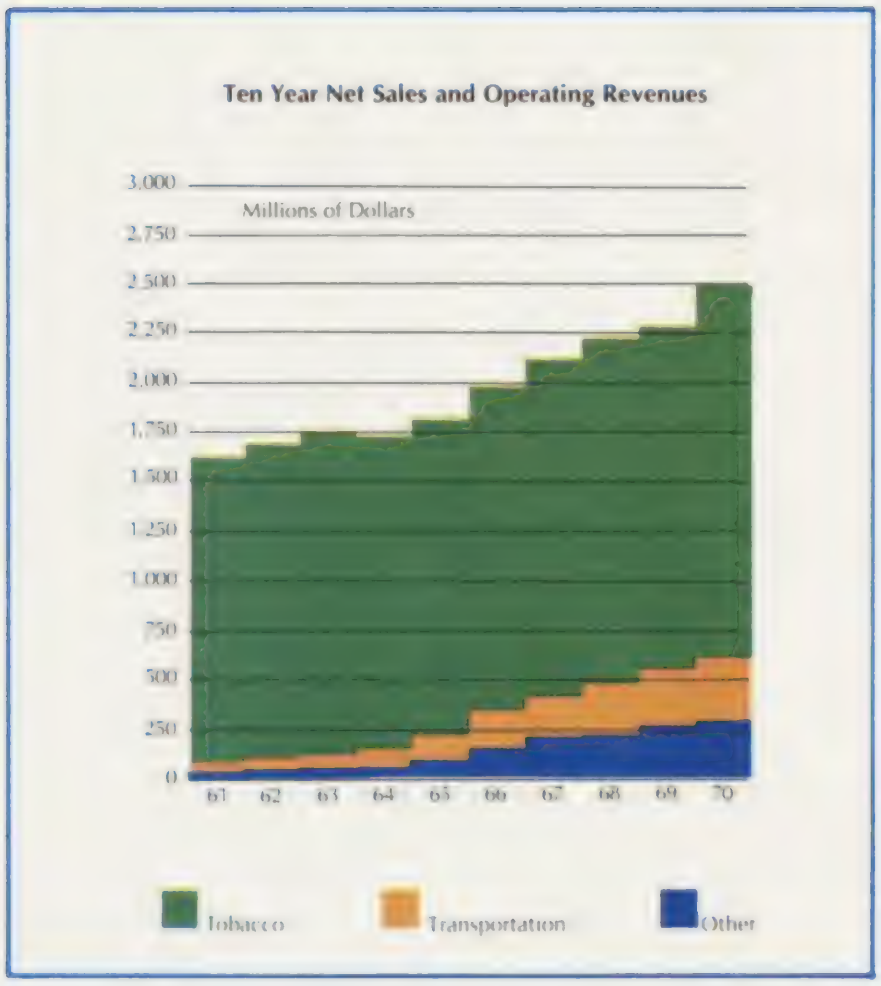
Net Sales and Operating Revenues

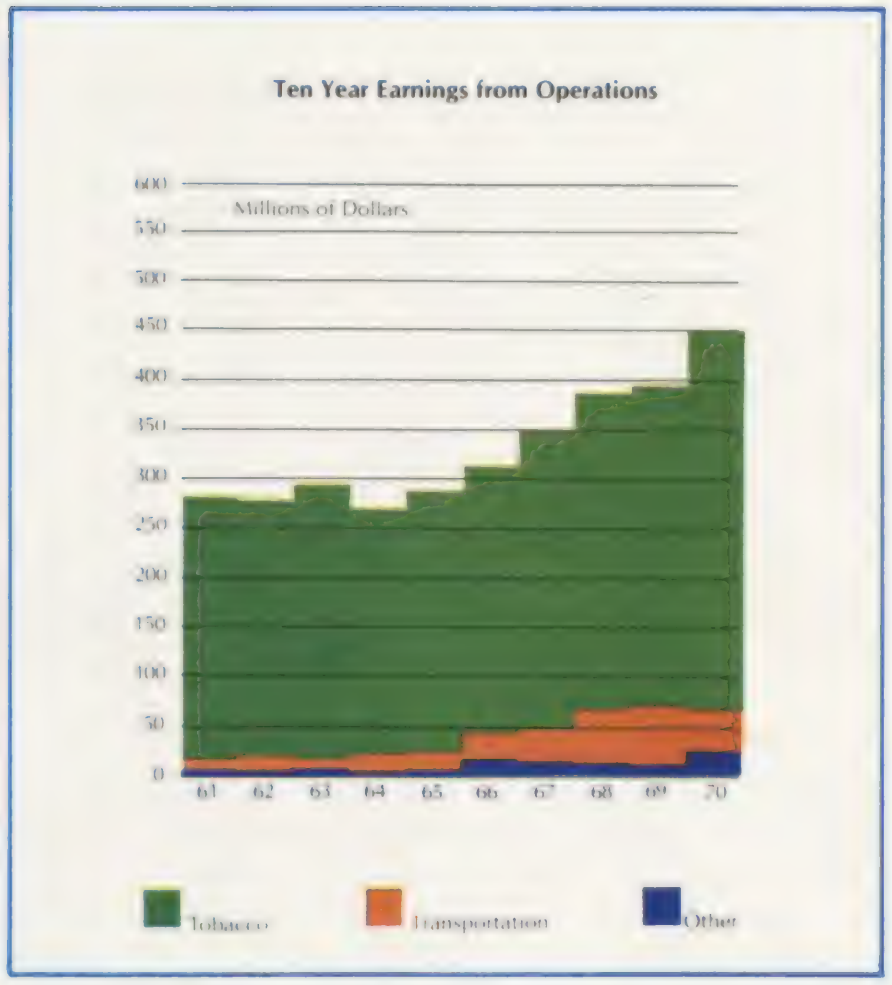
The gains in net sales and operating revenues are attributable to improved performances by each segment of the Company's operations. Tobacco sales, representing 73% of the consolidated total, increased 6% as a result of increased prices and a 2.4% gain in cigarette unit sales. (Tobacco sales included excise taxes of $698,576,000 in 1970 and $677,607,000 in 1969.) Transportation revenues rose 34%, or $94,572,000, over the prior year. The transportation gain is attributable to expanded trade routes in 1970 and lower than normal revenues in 1969 as a result of the longshoremen's strike in that year. Sales of other products, including food, aluminum products and packaging, and industrial corn products, increased $31,344,000 and contributed 12% to the consolidated total.

Earnings from Operations

Consolidated earnings from operations of $446,514,000 increased $58,364,000 or 15% over the 1969 amount of $388,150,000. Tobacco earnings from operations gained $62,805,000 as a result of higher cigarette unit sales and increased prices, partially offset by rising manufacturing costs and the expense of new brand introductions. A decline in transportation earnings from operations reflects increasing competition, higher operating costs and the cost of expanding trade routes. It is anticipated that these conditions may continue in the short term; however, it is hoped that profit margins of the Company's transportation business will improve with the possibility of increased rates in some areas and the restoration of cuts in others.

Earnings from operations of the Company's other businesses doubled in 1970, increasing $12,780,000 over 1969. Significant improvement in the food, aluminum products and packaging, and industrial corn refining segments contributed to this gain. Also included in the 1970 figures for the first time are American Independent Oil Company's earnings from operations for its fourth fiscal period.





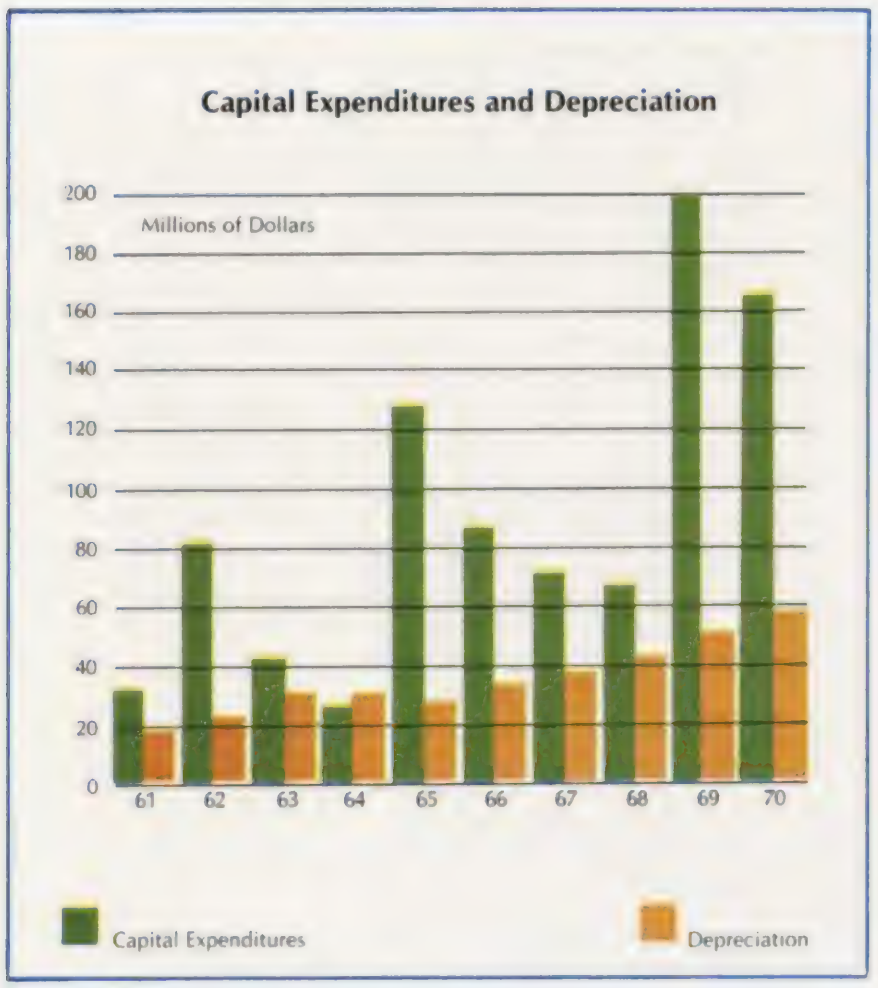
NET SALES AND OPERATING REVENUES
(Dollars in Thousands)

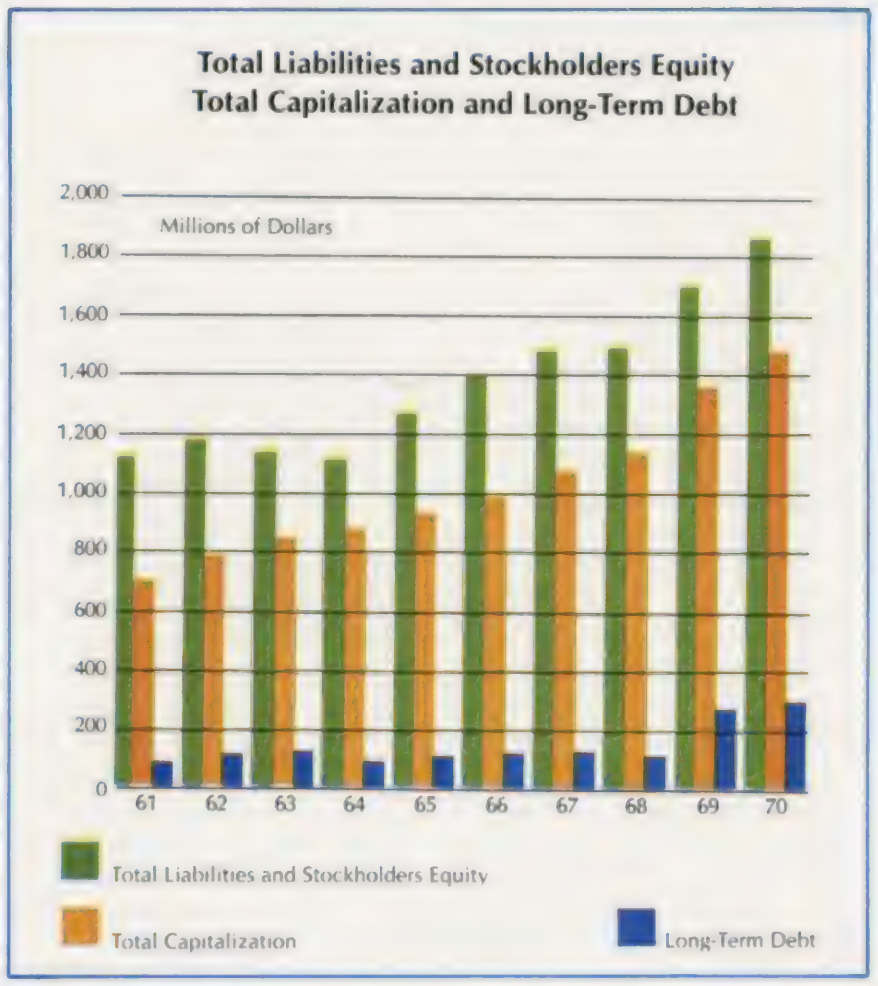
	1970	%	1969	%
Tobacco	$1,815,902	73.1	$1,709,914	75.9
Transportation	374,906	15.1	280,334	12.4
Other	293,791	11.8	262,447	11.7
Consolidated	$2,484,599	100.0	$2,252,695	100.0

EARNINGS FROM OPERATIONS*
(Dollars in Thousands)

	1970	%	1969	%
Tobacco	$382,551	85.7	$319,746	82.4
Transportation	38,632	8.6	55,853	14.4
Other	25,331	5.7	12,551	3.2
Consolidated	$446,514	100.0	$388,150	100.0

*Earnings before interest and debt expense and provision for income taxes.



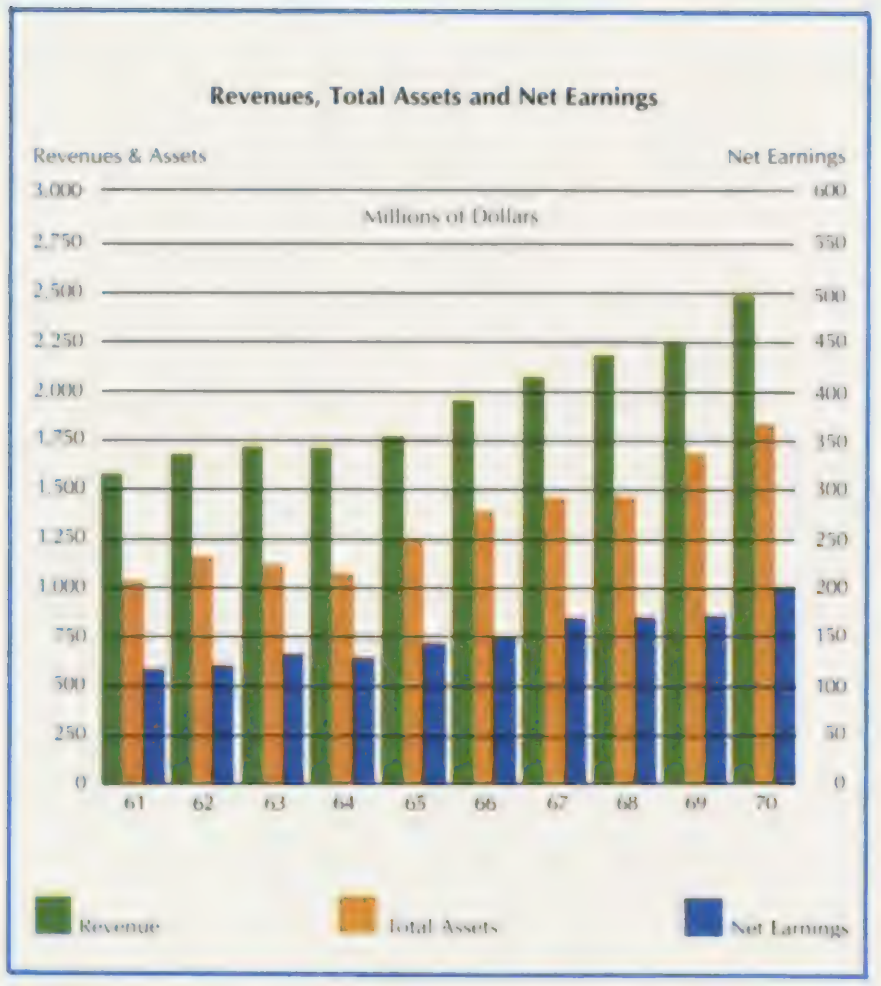


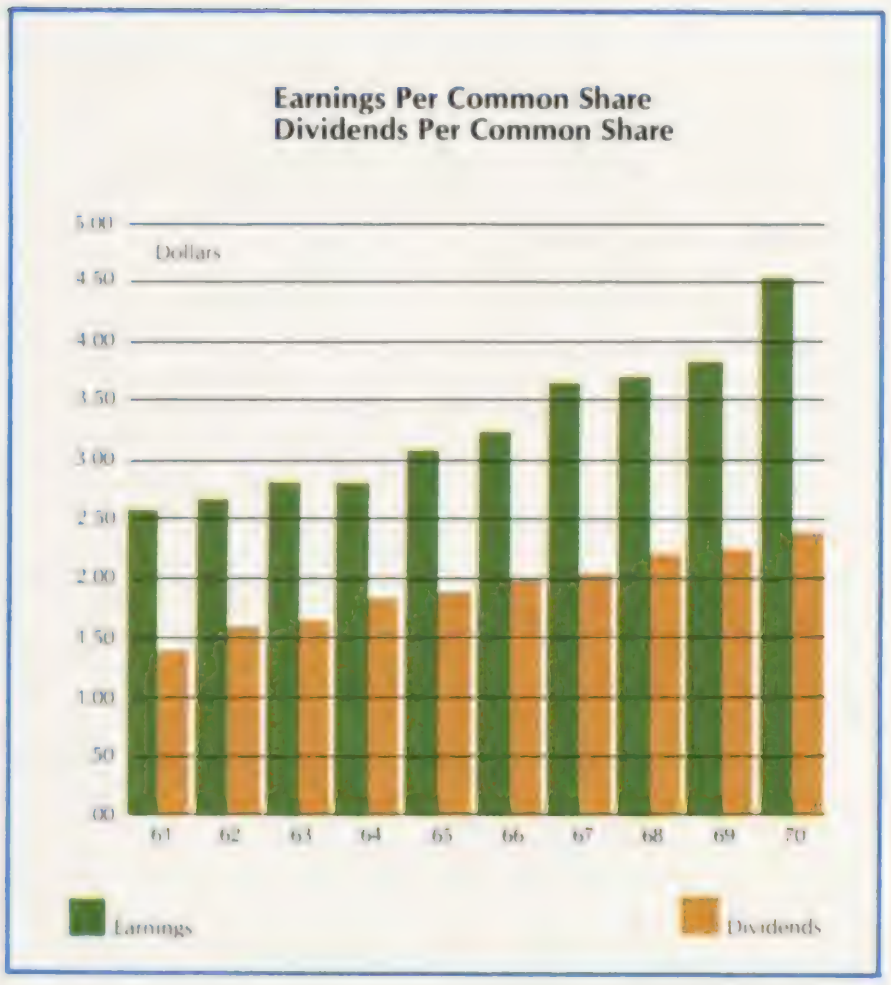
Dividends

Dividends per share of Common Stock totaled $2.40 per share in 1970, marking the seventeenth consecutive year of increased dividend payments. Dividends paid during the year on the Common and Preferred stocks aggregated $114,859,000, the highest in the Company's seventy-one years of consecutive dividend payments.

Debt Position

In December, 1970, the Company acquired one containership newly constructed for the Matson Navigation Company, and has contracted to purchase a second Matson containership which is to be completed early in 1971. These vessels are being financed by long-term debt which increased $13,750,000 with the delivery of the first vessel. During the year the Company borrowed $35,960,000 under interim financing agreements in connection with the eight super containerships being constructed in the Federal Republic of Germany and The Netherlands. Arrangements have been made to replace the interim financing with long-term financing as the eight vessels are completed. At present exchange rates, it is estimated the eight vessels will cost $352 million. Of this total amount, $28 million has been supplied out of internal funds, $36 million has been supplied by interim bank financing, and $178 million will be supplied by banks as construction progresses, leaving $110 million remaining to be supplied from internal funds in the next three years.





During 1970 payments of $28,196,000 were made on long-term debt, which totaled $296,094,000 at year-end (excluding $27,542,000 of long-term debt maturing during 1971). Short-term debt, which totaled $136,444,000 at year-end 1970, increased $19,822,000 over year-end 1969. The Company was free of short-term debt twice during the month of August.

Capital Expenditures

Outlays for capital expenditures amounted to $164,619,000 in 1970, or $80,381,000 less than the 1970 estimate made at this time last year. This difference was the approximate amount that would have been spent for equipment needed for the United States Lines charter arrangement, which was delayed. The 1970 outlay was the second highest in the Company's history, exceeded only by the record $197,903,000 in 1969. Of the total 1970 capital expenditure, $140,735,000, or 85%, related to the acquisition, conversion and construction of vessels and purchase of associated equipment to expand Sea-Land's containerized fleet. During the year the construction of a new cigarette manufacturing plant in Puerto Rico was completed. The Company also continued modernization of tobacco manufacturing facilities and expansion and modernization of aluminum products and packaging, industrial corn refining, and food processing facilities.

Capital expenditures in 1971 for currently approved programs are estimated to be $150 million, largely the continuation of the eight-vessel program referred to above.

Ten Year Financial Summary

(Dollar Amounts in Thousands Except Share Statistics)

Year ended December 31	1970	1969	1968
REVENUES, EARNINGS AND DIVIDENDS			
Net sales and operating revenues:			
Tobacco	$1,815,902	$1,709,914	$1,732,577
Transportation	374,906	280,334	226,383
Other	293,791	262,447	229,911
Total	2,484,599	2,252,695	2,188,871
Earnings from operations:			
Tobacco	382,551	319,746	320,850
Transportation	38,632	55,853	50,523
Other	25,331	12,551	13,345
Total	446,514	388,150	384,718
Interest and debt expense	30,914	23,092	14,327
Provision for income taxes	213,715	191,283	195,767
Extraordinary items, net of income taxes	—	—	—
Net earnings	201,885	172,305	168,930
Dividends paid on Preferred stocks (historical)	18,275	11,538	1,353
Dividends paid on Common Stock (historical)	96,584	90,530	88,518
FINANCIAL POSITION			
Working capital	571,789	622,881	683,756
Inventories	702,558	723,968	757,135
Total current assets	902,436	921,488	957,484
Net property, plant and equipment	627,927	524,876	381,413
Total assets	1,857,651	1,693,373	1,476,562
Short-term debt	136,444	116,622	107,500
Current maturities of long-term debt	27,542	23,395	23,670
Income taxes accrued	50,072	34,881	47,063
Total current liabilities	330,647	298,607	273,728
Long-term debt less current maturities	296,094	274,031	112,502
Book value of Preferred Stock	85,783	85,774	105,657
Book value of Common Stock	1,082,155	992,950	918,594
OTHER INFORMATION			
Capital expenditures	164,619	197,903	67,079
Depreciation and amortization	57,153	45,369	41,312
Net earnings per common share	4.56	3.82	3.71
Net earnings per common share—assuming full dilution	4.10	3.57	3.48
Dividends per common share	2.40	2.25	2.20
Book value per common share	26.89	24.68	22.83
Average number of common shares outstanding	40,242,252	40,235,578	40,235,552
Average number of common shares outstanding—assuming full dilution	49,188,427	48,123,711	48,184,929
Number of shareholders at year-end	137,504	136,539	136,129

1967	1966	1965	1964	1963	1962	1961
$1,695,181	$1,635,238	$1,601,014	$1,571,762	$1,632,892	$1,597,091	$1,527,181
180,496	147,464	101,782	94,158	75,699	64,425	44 678
216,233	168,961	92,134	42,040	39,553	30,451	28,345
2,091,910	1,951,663	1,794,930	1,707,960	1,748,144	1,691,967	1,600,204
300,533	268,017	261,873	247,490	275,194	262,161	264,359
33,315	24,312	12,448	9,316	3,477	5,497	4,515
14,668	17,919	8,765	8,657	9,538	7,673	8,222
348,516	310,248	283,086	265,463	288,209	275,331	277,096
16,104	11,823	7,108	7,508	10,458	10,248	8,035
161,485	145,623	136,812	129,404	148,840	140,672	147,194
—	—	6,701	1,556	245	908	—
166,344	149,939	143,101	128,893	129,344	124,434	121,119
1,423	1,485	1,600	1,761	1,738	1,376	1,044
82,284	79,825	75,006	73,734	67,602	64,512	56,439
623,385	583,842	626,865	668,419	613,893	558,685	537,875
801,134	795,162	787,407	777,651	797,703	846,938	845,787
983,680	964,435	927,302	887,640	892,089	943,159	938,622
350,964	315,929	265,912	194,213	221,111	211,514	148,070
1,475,843	1,395,981	1,254,126	1,100,929	1,136,009	1,181,199	1,113,391
175,500	180,650	125,000	67,000	114,500	222,350	258,556
19,388	16,080	15,622	11,282	15,709	18,812	11,797
46,455	68,375	80,304	83,789	96,640	90,399	93,270
360,295	380,593	300,437	219,221	278,196	384,474	400,747
121,239	115,524	103,945	90,089	115,668	112,463	84,824
104,958	100,416	99,998	85,550	87,727	90,233	93,129
839,802	760,003	719,158	685,859	636,000	575,311	517,277
71,516	86,156	126,626	26,819	40,948	81,139	32,376
37,619	33,844	27,398	29,621	29,340	20,951	15,268
3.65	3.22	3.08	2.77	2.78	2.66	2.58
3.45	3.10	2.96	2.71	2.72	2.58	2.48
2.05	2.00	1.85	1.80	1.65	1.60	1.40
20.87	18.83	17.89	16.78	15.52	14.05	12.63
40,302,863	40,800,745	40,528,050	40,968,611	40,964,177	40,957,619	40,957,106
47,784,586	47,844,569	47,800,123	47,073,953	46,922,492	47,696,453	48,143,363
134,038	131,371	118,281	114,010	103,282	97,383	89,550

Consolidated Balance Sheets

December 31,1970 and 1969
(Dollars in Thousands)

	1970	1969
ASSETS		
Current assets:		
Cash	$ 48,367	$ 39,953
Marketable securities — at cost (approximate market value—$4,250 and $6,314 respectively)—Note B	6,800	6,800
Accounts receivable (less allowances of $7,510 and $4,379 respectively)	139,044	145,602
Leaf tobacco, supplies, manufactured products, etc. — at cost (substantially all on last-in, first-out basis)	702,558	723,968
Prepaid expenses	5,667	5,165
Total current assets	902,436	921,488
Property, plant and equipment — at cost — Notes C, D and H:		
Land and land improvements	14,565	12,489
Buildings and leasehold improvements	164,985	147,694
Machinery and equipment	302,648	271,220
Vessels, containers and other marine equipment	416,270	347,799
Construction-in-process	88,821	58,305
	987,289	837,507
Less allowances for depreciation and amortization	359,362	312,631
Net property, plant and equipment	627,927	524,876
Investments in and advances to unconsolidated subsidiaries — Note A	96,271	18,649
Cost in excess of net assets of businesses acquired— Note A	185,888	184,644
Deferred charges and other assets	45,129	43,716
	$1,857,651	$1,693,373

See Notes to Consolidated Financial Statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	1970	1969
Current liabilities:		
Notes payable	$ 136,444	$ 116,622
Accounts payable and sundry accrued accounts	116,589	123,709
Current maturities of long-term debt — Note D	27,542	23,395
Income taxes accrued	50,072	34,881
Total current liabilities	330,647	298,607
Reserves and non-current liabilities	17,041	12,679
Deferred income taxes	45,931	29,332
Long-term debt (less current maturities) — Note D	296,094	274,031
Stockholders' equity — Notes E and F:		
Preferred Stock — $2.25 Convertible Preferred Stock — without par value		
Authorized — 8,293,985 shares; issued—8,115,685 shares in 1970	85,783	85,774
Common Stock — Par $5		
Authorized — 60,000,000 shares; issued — 40,290,220 shares in 1970	201,451	204,858
Paid-in capital	10,398	8,492
Earnings retained	870,306	809,417
	1,167,938	1,108,541
Less cost of stock in treasury:		
Common Stock (735,981 shares in 1969)	—	29,817
Total stockholders' equity	1,167,938	1,078,724
	$1,857,651	$1,693,373

See Notes to Consolidated Financial Statements.

Consolidated Statement of Earnings

For the Years Ended December 31, 1970 and 1969
(Dollars in Thousands)

	1970	1969
Net sales and operating revenues	$2,484,599	$2,252,695
Costs and expenses:		
Cost of products sold and operating expenses	1,772,238	1,630,747
Selling, advertising, administrative and general expenses	274,547	234,753
Earnings from domestic and Canadian operations	437,814	387,195
Equity in earnings from unconsolidated foreign operations	8,700	955
Earnings from operations	446,514	388,150
Interest and debt expense	30,914	23,092
	415,600	365,058
Less:		
Provision for income taxes — Note J	213,715	191,283
Earnings applicable to purchased portion of McLean Industries, Inc. Common Stock prior to acquisition	—	1,470
	213,715	192,753
Net earnings	$ 201,885	$ 172,305
Net earnings per common share	$4.56	$3.82
Net earnings per common share — assuming full dilution — Note K	4.10	3.57

Consolidated Statement of Earnings Retained

For the Years Ended December 31,1970 and 1969
(Dollars in Thousands)

	1970	1969
Earnings retained at beginning of year	$ 809,417	$ 739,124
Add net earnings	201,885	172,305
	1,011,302	911,429
Deduct:		
Cash dividends:		
The Company:		
Preferred Stock — 3.60% Series	—	265
$2.25 Convertible Preferred Stock	18,275	11,052
Common Stock	96,584	90,530
McLean Preferred Stock	—	221
Total cash dividends	114,859	102,068
Excess of stated value of the Company's $2.25 Convertible Preferred Stock over the pooled portion of McLean's common equity	—	(56)
Retirement of Common Stock held in treasury	26,137	—
Earnings retained at end of year	$ 870,306	$ 809,417

See Notes to Consolidated Financial Statements.

Consolidated Statement of Source and Disposition of Funds

For the Years Ended December 31,1970 and 1969
(Dollars in Thousands)

	1970	1969
Source of funds:		
Net earnings	$201,885	$172,305
Items not involving funds:		
Add:		
Depreciation and amortization	57,153	45,369
Deferred income taxes	16,599	7,244
Minority interest in earnings of subsidiary	—	1,470
Reserves and non-current liabilities	4,362	3,934
Deduct:		
Equity in undistributed net earnings of unconsolidated subsidiaries	4,499	955
Funds from operations	275,500	229,367
Proceeds from long-term debt	54,406	199,042
Proceeds from issuance or conversion of Company's stock	2,188	125
Disposals of net property, plant and equipment	8,458	11,148
Decrease in inventories	21,410	33,167
Increase in notes payable	19,822	9,122
Increase (decrease) in accounts payable and sundry accrued accounts	(7,120)	28,214
Increase (decrease) in income taxes accrued	15,191	(12,182)
	389,855	498,003
Disposition of funds:		
Expenditures for expansion and modernization of property, plant and equipment	164,619	197,903
Cash purchases of McLean Industries, Inc. common shares in 1969	—	125,020
Investment in and advances to unconsolidated subsidiaries	73,123	(129)
Cash dividends	114,859	102,068
Retirement of Preferred stocks	—	24,465
Repayment of long-term debt	28,196	37,788
Increase (decrease) in accounts receivable	(6,558)	6,115
Other, net	7,202	14,592
	381,441	507,822
Increase (decrease) in funds for the year	8,414	(9,819)
Cash and marketable securities at beginning of year	46,753	56,572
Cash and marketable securities at end of year	$ 55,167	$ 46,753

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

NOTE A — Principles of Consolidation and Other Matters.

The Company's consolidation policy is to include in its consolidated financial statements the accounts of domestic and Canadian operations after eliminating significant intercompany accounts and transactions. The earnings from operations, interest expense and provision for income taxes of American Independent Oil Company (acquired September 1, 1970 for $55,500,000 cash) for its fourth fiscal quarter of 1970 and other foreign operations (for the calendar years reported) are included in consolidated results. Investments in unconsolidated operations are carried at equity.

Foreign assets and liabilities (after elimination of intercompany items) of the Company's operations are as follows:

	(Dollars in Thousands)	
	1970	**1969**
Assets	$254,920	$100,600
Liabilities	105,043	47,704

McLean Industries Inc. was merged into the Company on May 13, 1969. Prior to the merger, 2,304,000 shares of McLean's 10,632,000 common shares were purchased for $115,200,000 cash. In accordance with the terms of the merger agreement, each McLean shareholder not requesting the right of appraisal received one share of the Company's $2.25 Convertible Preferred Stock for each share of McLean Common Stock held. A total of 8,109,781 shares of McLean Common Stock were exchanged for $2.25 Convertible Preferred Stock. Holders of 218,219 shares of McLean Common Stock who perfected the right to appraisal were paid $45.00 per share aggregating $9,819,855.

For accounting purposes, the merger was treated as a pooling of interests as to approximately 76% and a purchase as to 24%, and has been reflected accordingly in the Consolidated Financial Statements.

The Company is not amortizing the cost in excess of the net assets of businesses acquired.

NOTE B — Marketable Securities.

On February 17, 1971, the date of the Report of Independent Accountants for the year 1970, marketable securities had a value of $5,161,000.

NOTE D — Long-Term Debt.

Long-term debt consists of the following:

2½% Promissory Note, due October 1, 1972	
3% Debentures, due October 1, 1973 (reduced by $4,514,000 and $5,000,000 of such debentures held by the Company on December 31, 1970 and 1969, respectively, for future sinking fund requirements)	
7% Subordinated Debentures, due June 1, 1989	
7⅞% Debentures, due September 1, 1994	
8⅛% Notes, due September 1, 1974	
Equipment Obligations (6% to 9%) secured by liens on containers and equipment, having a net book value of approximately $114,000,000, payable in monthly installments through 1978	
Vessel Construction Loans from various banks in the Federal Republic of Germany and The Netherlands, at rates varying from 8% to 8¾%	
Vessel Mortgage Note, payable in quarterly installments through December 31, 1975, with interest at the prime commercial rate plus ½%	
Other indebtedness	

Payment schedule of debt due after one year (1):

Due in:	
1972	$ 54,247
1973	44,369
1974	61,472

(1) Included in 1972 and 1973 are repayments of $22,732 and $13,228, respectively, representing vessel construction loans which will be replaced with long-term foreign financing. See Note H.

NOTE C — Depreciation and Amortization.

During the year, depreciation and amortization charged against earnings totaled $57,153,000 compared with $45,369,000 in 1969. Depreciation on assets owned by the Company and its subsidiaries, other than assets used in the transportation business, was determined using accelerated methods for the most part for both book and income tax purposes. Depreciation on assets used in the transportation business was determined using the straight-line method for book purposes and accelerated methods for income tax purposes; therefore, provision was made for deferred income taxes which may be payable in future years.

(Dollars in Thousands)

	December 31, 1970			December 31, 1969		
	Total	Due Within One Year	Due After One Year	Total	Due Within One Year	Due After One Year
.....	$ 4,000	$ 2,000	$ 2,000	$ 6,000	$ 2,000	$ 4,000
.....	18,486	486	18,000	23,000	—	23,000
.....	15,849	—	15,849	15,849	—	15,849
.....	100,000	—	100,000	100,000	—	100,000
.....	50,000	—	50,000	50,000	—	50,000
.....	80,790	21,380	59,410	101,887	21,265	80,622
.....	35,960	—	35,960	—	—	—
.....	13,750	2,750	11,000	—	—	—
.....	4,801	926	3,875	690	130	560
	$323,636	$27,542	$296,094	$297,426	$23,395	$274,031

1975	15,214
1976 and thereafter	120,792
	$296,094

NOTE E—Capital Stock Redemption and Conversion Provisions and Substitute Stock Options.

Each share of the $2.25 Convertible Preferred Stock is convertible into 1.5 shares of the Company's Common Stock on surrender of the Preferred share and payment of $22 in cash. The Company may redeem the Convertible Preferred Stock after June 30, 1979, at $50 per share plus accrued dividends to the redemption date. The aggregate redemption value of shares outstanding at December 31, 1970, was $405,784,000. In the event of involuntary liquidation, holders of $2.25 Convertible Preferred Stock are entitled to $10.57 per share plus accrued dividends.

Of the authorized but unissued common shares, 12,434,753 are reserved for conversion of 8,115,685 shares of $2.25 Convertible Preferred Stock issued and 174,150 of such shares issuable upon exercise of substitute stock options.

Substitute stock options for 228,100 shares of $2.25 Convertible Preferred Stock were issued in accordance with the terms of the merger agreement with McLean Industries, Inc., pursuant to a former plan for McLean officers and employees. These substitute options expire at various dates to January 7, 1974. Substitute stock option issue prices and activity during 1969 and 1970 are shown in the table below.

	Shares				
Option price per share	$4.50	$37.25	$40.00	$42.50	Total
1969					
Options substituted, May 13, 1969	2,000	217,800	1,000	7,300	228,100
Cancelled	—	6,525	—	—	6,525
Exercised	2,000	3,100	—	—	5,100
Balance, December 31, 1969	—	208,175	1,000	7,300	216,475
1970					
Cancelled	—	4,075	1,000	—	5,075
Exercised	—	37,250	—	—	37,250
Balance, December 31, 1970	—	166,850	—	7,300	174,150

NOTE F—Capital Changes.

The following changes in the Company's capital accounts have occurred during the two years ended December 31, 1970:

	Shares	Amount (In Thousands)
Preferred Stock — 3.60% Series — Par $100		
Balance at beginning of 1969	490,000	$ 49,000
Stock in treasury cancelled, May 13, 1969	(290,000)	(24,571)
Shares converted into $80 principal amount of debentures or purchased for cash during 1969	(200,000)	(16,009)
Amount transferred to paid-in capital in 1969	—	(8,420)
Balance, December 31, 1969 and 1970	—	$ —

NOTE F—Capital Changes. (Continued)

	Shares	Amount (In Thousands)
$2.25 Convertible Preferred Stock — Without Par Value ($10.57 per share stated value)		
Shares issued in connection with the merger of McLean Industries, Inc. into the Company	8,109,781	$ 85,721
Sales under substitute stock options during 1969	5,100	54
Shares converted into Common Stock of the Company during 1969	(71)	(1)
Balance, December 31, 1969	8,114,810	85,774
Sales under substitute stock options during 1970	37,250	394
Shares converted into Common Stock of the Company during 1970	(36,375)	(385)
Balance December 31, 1970	8,115,685	$ 85,783
Common Stock — Par $5		
Balance at beginning of 1969	40,971,533	$204,858
Shares issued during 1969 upon conversion of the Company's $2.25 Convertible Preferred Stock	106	—
Balance, December 31, 1969	40,971,639	204,858
Shares issued during 1970 upon conversion of the Company's $2.25 Convertible Preferred Stock	54,562	273
Stock in treasury cancelled, June 29, 1970	(735,981)	(3,680)
Balance, December 31, 1970	40,290,220	$201,451
Paid-In Capital		
Balance at beginning of 1969		$ —
Excess of par value of 490,000 shares of Reynolds Preferred Stock, 3.60% Series over: the cost of 290,000 treasury shares; the principal amount of 7% Subordinated Debentures issued in exchange for 198,113 shares and the cost of 1,887 shares purchased for cash during 1969		8,420
Proceeds ($22 per share) from conversion of the $2.25 Convertible Preferred Stock and the stated value ($10.57 per share) of the converted preferred stock less par value ($5.00 per share) of the common shares issued during 1969		2
Proceeds from exercise of substitute stock options to purchase $2.25 Convertible Preferred Stock less the stated value of the shares issued during 1969		70
Balance, December 31, 1969		8,492
Proceeds ($22 per share) from conversion of the $2.25 Convertible Preferred Stock and the stated value ($10.57 per share) of the converted preferred stock less par value ($5.00 per share) of the common shares issued during 1970		912
Proceeds from exercise of substitute stock options to purchase $2.25 Convertible Preferred Stock less the stated value of the shares issued during 1970		994
Balance, December 31, 1970		$ 10,398

NOTE G — Pension Plans.

The Company and its consolidated subsidiaries have several pension plans covering substantially all employees. The total expense for such plans for the year was $7,718,000 compared with $5,845,000 for 1969, of which the major portion applied to the Employees' Retirement Plan of R. J. Reynolds Tobacco Company, a plan funded under the aggregate cost method. The Company's policy with respect to this plan is to fund pension cost accrued. The total amount of assets so funded exceeded in the aggregate the actuarially computed value of vested benefits according to the most recent actuarial valuation.

Contributions are also made to various union administered plans established under the terms of collective bargaining agreements.

NOTE H — Commitments and Contingencies.

Leases and time charters for vessels and related equipment and facilities are used extensively in connection with the transportation business and generally provide for initial periods of ten years, with renewal periods of up to thirty additional years. Such lease and time charter expenses amounted to approximately $32,435,000 in 1970 and $24,150,000 in 1969 and are estimated to be $32,500,000 in 1971.

In October, 1970, the Company entered into an agreement with Matson Navigation Company to purchase two containerships then under construction for a basic contract price of $27,500,000. Purchase of the first vessel which was delivered in December, 1970 was financed by long-term borrowing. The Company has arranged long-term financing for the second vessel which is scheduled to be delivered early in 1971.

Construction is proceeding on five super containerships in the Federal Republic of Germany and three in The Netherlands. Interim financing in the amount of $214 million (at December 31, 1970 exchange rates) with banks in Germany and The Netherlands will be replaced with long-term foreign financing as the vessels are completed. The summary below shows, based on year-end exchange rates, the estimated total cost of the eight vessels and estimated repayments for the bank financing:

	(Dollars in Thousands)		
	Total Project Cost	Expended Through December 31, 1970	Remaining Commitments December 31, 1970
Bank Financing	$213,882	$35,960	$177,922
From Internal Funds	138,187	27,771	110,416*
Total	$352,069	$63,731	$288,338

*Due 1971-1973.

Bank financing repayment schedule: (Dollars in Thousands)

1971	$ —
1972	1,590
1973	12,322
1974	19,322
1975	19,322
1976 and thereafter	161,326
	$213,882

At December 31, 1970, the Company also had various other capital spending commitments of approximately $45 million.

On November 9, 1970, a merger agreement was entered into under which the Company would acquire all of the Common Stock of United States Lines, Inc., which is a subsidiary of Walter Kidde & Company, Inc., for a $65,000,000 promissory note of R. J. Reynolds Tobacco Company. The note will bear interest from November 9, 1970 at an annual rate of 8% plus interest at the rate of 6% per annum on deferred installments of interest. The note will be due no later than November 9, 1976. Applications for approval of the proposed merger have been filed, as required by law, with the Federal Maritime Commission and the Interstate Commerce Commission. If the necessary approvals are not obtained, Reynolds Tobacco will be obligated under a supplemental agreement with Kidde to produce equivalent consideration for Kidde within 24 months of any disapproval and in any event no later than November 9, 1976 and United States Lines will be sold or disposed of otherwise for the account of Reynolds Tobacco. The merger agreement modifies the October 27, 1969 Time Charter and an Agreement of Lease and Sublease between Sea-Land and United States Lines under which Sea-Land proposes to charter from United States Lines 16 containerships and to lease related equipment for a period of 20 years (with an option to purchase at the end of the period), and provides for the termination of the charter and equipment lease in the event the proposed merger is not approved. Since the Company cannot own or operate United States Lines without the required Government approvals, neither the merger trans-

action nor the operating results of United States Lines have been included in the consolidated financial statements. (See Note I below.)

NOTE I—Legal Matters.

In November, 1969, American Export Isbrandtsen Lines, Inc. filed an antitrust suit in the United States District Court for the Southern District of New York seeking a preliminary as well as a permanent injunction against consummation of the charter and equipment lease referred to in Note H above, seeking an order that the Company be required to divest itself of McLean and that Kidde be required to divest itself of United States Lines, and asking treble damages. The request for preliminary injunction was withdrawn in December, 1969, and, by stipulation, the entire case has been stayed pending a decision by the Federal Maritime Commission in proceedings for approval of the proposed charter and equipment lease.

The Department of Justice on December 15, 1970, filed an antitrust suit in the United States District Court for the District of New Jersey seeking an injunction prohibiting the proposed merger referred to in Note H above and an order rescinding the supplemental agreement referred to in said Note. The Federal Maritime Commission has moved to intervene in the lawsuit and for a stay of proceedings in the suit until determination of the proceedings pending before the Commission for approval of the merger. The Department of Justice has asked the Court for a preliminary injunction prohibiting consummation of the merger and of the supplemental agreement. Hearings before the Commission began February 17, 1971, and it is not known how much time will elapse before a determination is ultimately made by the Commission. As of such date, the Court had not made a decision on the Commission's motion to stay proceedings in the Department of Justice's lawsuit and the latter's motion for a preliminary injunction had not been argued.

The Company or its subsidiaries are defendants in other litigation which in the aggregate is not expected to have any material effect on the Company's financial position.

NOTE J—Provision for Income Taxes.

Provision for income taxes includes current and deferred taxes in the following amounts:

	(Dollars in Thousands)	
	1970	1969
Current	$197,116	$184,039
Deferred	16,599	7,244
	$213,715	$191,283

The provision for income taxes reflects reductions resulting from investment tax credits of $2,614,000 in 1970 and $9,096,000 in 1969. Investment tax credits, resulting primarily from investments in transportation assets, are used to reduce the provision for income taxes in the year the credits are first available. Deferred income taxes result from differences between book and tax accounting for depreciation, vessel charter payments and pension expense. For book purposes, charter costs are expensed on a straight-line basis over the estimated vessel service life (generally 15 years). For tax purposes, vessel charter payments are deducted in accordance with charter agreements which generally provide for an initial 10-year period and renewals thereafter at reduced rates. The difference between charter costs for book and tax purposes is included as a deferred charge on the balance sheet.

There are a number of issues pending as a result of Internal Revenue Service audits of certain prior years, but the Company believes any adjustments which may result will not materially affect the Company's financial position.

NOTE K—Net Earnings Per Common Share—Assuming Full Dilution.

Net earnings per common share assuming full dilution are calculated using the treasury stock method for determining fully diluted shares. This calculation assumes all substitute stock options are exercised and that all shares of $2.25 Convertible Preferred Stock outstanding during the year (plus shares of $2.25 Convertible Preferred Stock which would be issued on exercise of substitute options) were converted into Common Stock and the proceeds used to purchase treasury common shares at the higher of the average daily price or year-end closing price of the Common Stock. Under these assumptions there would have been 49,188,427 and 48,123,711 average common shares outstanding during 1970 and 1969, respectively. The 1969 computation includes the assumption that the $2.25 Convertible Preferred Stock was outstanding prior to the merger with McLean Industries, Inc., on May 13, 1969.

NOTE L—Divestiture of Penick and Ford, Limited.

On September 22, 1969, the Company consented to a Final Judgment requiring divestiture within two years of the corn wet milling and potato starch businesses acquired from Penick & Ford, Ltd., Incorporated. The divestiture may be by public offering or distribution to the Company's common shareholders of Penick stock, or by sale of the stock or assets and business of Penick to an acceptable purchaser. However, the financial effects of the divestiture cannot now be determined because the method and terms of divestiture are as yet unknown.

At December 31, 1970, the Company's investment in Penick was approximately $79,316,000 of which approximately $30,800,000 represented cost in excess of net assets of businesses acquired. During 1970 Penick had net sales of approximately $62,582,000, and net earnings of approximately $1,325,000.

NOTE M — Subsequent Events.

On January 21, 1971, the Company and Rothmans International Group announced negotiations looking toward joint efforts through subsidiaries in the production and marketing of cigarettes and other tobacco products in various areas of the world other than North America and Africa. The form and nature of the future association will be determined in these negotiations. Rothmans International Group has extensive tobacco interests in many parts of the world outside the United States.

REPORT OF INDEPENDENT ACCOUNTANTS

ERNST & ERNST

Fourth & Main Streets,
Winston-Salem, N. C.

R. J. REYNOLDS INDUSTRIES, INC.,
ITS DIRECTORS AND STOCKHOLDERS

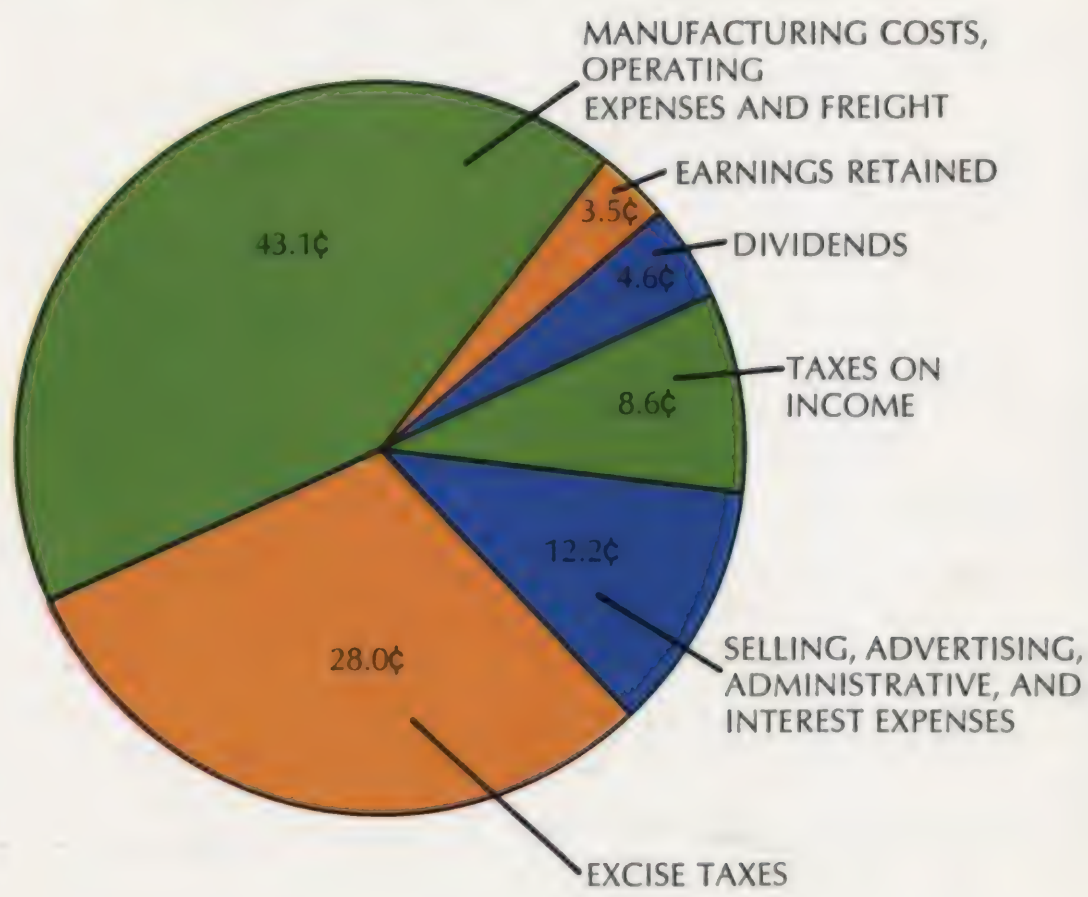
We have examined the consolidated financial statements of R. J. Reynolds Industries, Inc. and consolidated subsidiaries for the two years ended December 31, 1970. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, subject to adjustments, if any, that may result from the divestiture of Penick & Ford, Limited described in Note L, the accompanying balance sheet and statements of earnings, earnings retained, and source and disposition of funds present fairly the financial position of R. J. Reynolds Industries, Inc. and consolidated subsidiaries at December 31, 1970, and 1969, and the results of their operations, changes in stockholders' equity, and source and disposition of funds for each of the two years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst

February 17, 1971

DISTRIBUTION OF THE 1970 REVENUE DOLLAR



Products and Services

R. J. Reynolds Tobacco Company makes the nation's top seller in each of its product categories: WINSTON cigarettes, PRINCE ALBERT smoking tobacco and DAYS WORK plug chewing tobacco. Reynolds produces nearly one-third of all cigarettes sold in the United States.

Sea-Land Service, Inc. combines the flexibility of over-the-road trucking with the efficiency and low cost of waterway shipping. It currently serves 70 port terminals in 28 countries with 47 containerships and more than 44,000 computer-controlled containers.

RJR Foods, Inc. markets a variety of international and convenience foods, including CHUN KING Oriental foods, PATIO Mexican foods, HAWAIIAN PUNCH beverages, VERMONT MAID syrups, BRER RABBIT molasses and syrups, COLLEGE INN foods and MY*T*FINE desserts.

RJR Archer, Inc. produces specialty foil and sheet aluminum products, flexible packaging materials, florist foil materials, gift wrapping and protective vinyl wrap.

American Independent Oil Company is an independent oil producer and refiner. Its principal sales are to other oil companies. Aminoil's primary source of oil is in the Neutral Zone between Kuwait and Saudi Arabia, and the main refinery and desulfurization plant are in Kuwait.

Penick & Ford, Limited is engaged in corn wet milling and potato starch operations. Among the bulk products it sells to industry for a wide variety of uses are corn syrups and oils, corn and potato starches, dextrines and gums.

R. J. REYNOLDS INDUSTRIES, INC. DIRECTORS AND OFFICERS

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Chairman,
R. J. Reynolds Industries, Inc.

GORDON GRAY
Chairman,
National Trust for Historic Preservation

REUBEN P. HUGHES
Vice President,
RJR Foods, Inc.

WILLIAM R. LYBROOK
Senior Vice President and Secretary,
R. J. Reynolds Industries, Inc.

MALCOM P. McLEAN
President,
McLean Industries, Inc.

THRUSTON B. MORTON
Vice Chairman of the Board,
Liberty National Bank and
Trust Co., Louisville, Kentucky

CHARLES F. MYERS, JR.
Chairman and Chief Executive Officer,
Burlington Industries, Inc.

DAVID S. PEOPLES
President,
R. J. Reynolds Industries, Inc.

H. H. RAMM*
Senior Vice President and General Counsel,
R. J. Reynolds Industries, Inc.

FENTON D. ROYSTER*
Vice President,
R. J. Reynolds Tobacco Company

J. H. SHERRILL
Vice President,
R. J. Reynolds Tobacco Company

WILLIAM S. SMITH
President,
R. J. Reynolds Tobacco Company

J. PAUL STICHT
President,
Federated Department Stores, Inc.

COLIN STOKES
Chairman,
R. J. Reynolds Tobacco Company

CHAS. B. WADE, JR.
Senior Vice President,
R. J. Reynolds Tobacco Company

Officers

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Chairman and Chief Executive Officer

DAVID S. PEOPLES
President and Chief Administrative Officer

H. H. RAMM**
Senior Vice President
and General Counsel

WILLIAM R. LYBROOK
Senior Vice President and
Secretary

S. A. ANGOTTI
Vice President

C. F. BENBOW
Vice President

E. C. RITCHELL
Vice President

E. A. VASSALLO
Vice President

J. W. DOWDLE
Treasurer

R. A. EMKEN
Comptroller

* Retired December 31, 1970. C. F. Benbow and H. C. Roemer elected to fill vacancies.

** Retired December 31, 1970. Succeeded by H. C. Roemer, elected Vice President and General Counsel.

Registrar

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